

# **The South Caucasus 2021:**

## **Oil, Democracy and Geopolitics**

---

**Fariz Ismailzade and Glen E. Howard, Editors**



**Center for Strategic Studies**  
**Baku, Azerbaijan**



**The Jamestown Foundation**  
**Washington, DC**

## THE JAMESTOWN FOUNDATION

Published in the United States by  
The Jamestown Foundation  
1111 16<sup>th</sup> Street NW  
Suite 320  
Washington, DC 20036  
<http://www.jamestown.org>

Copyright © 2012 The Jamestown Foundation

All rights reserved. Printed in the United States of America. No part of this book may be reproduced in any manner whatsoever without written consent. For copyright and permissions information, contact The Jamestown Foundation, 1111 16<sup>th</sup> Street NW, Suite 320, Washington, DC 20036.

The views expressed in the book are those of the contributing authors and not necessarily those of the Jamestown Foundation.

For more information on this book of the Jamestown Foundation, email [pubs@jamestown.org](mailto:pubs@jamestown.org)

ISBN 978-0-9816905-8-2

Cover art provided by Peggy Archambault of Peggy Archambault Design

# QUALITATIVE ECONOMIC FEATURES OF THE SOUTH CAUCASIAN COUNTRIES: PAST, PRESENT AND FUTURE IN THE EUROPEAN CONTEXT

Vladimer Papava,  
Senior Research Fellow,  
Georgian Foundation for Strategic and International Studies

Immediately after the restoration of their national independence in 1991, the three countries of the South Caucasus – Armenia, Azerbaijan and Georgia<sup>1</sup> – came to meet the challenge of a transition to a market economy. Nearly twenty years later, it is quite natural to ask where these countries are now on their way toward a market-oriented transformation.

All of the post-Communist states, including the countries of the South Caucasus, are facing some new challenges within this period of a global financial crisis.

These countries' future includes a strategic choice to move toward the Western style market economy. Pursuing this option may lead the South Caucasian states, if not to a complete integration into the European Union (EU), at least to getting much closer to it and to its standards.

---

<sup>1</sup> Generally, I am a proponent of defining the Caucasus as made up of the Central Caucasus, consisting of Armenia, Azerbaijan and Georgia; the South Caucasus, consisting of the northern provinces of Turkey and Iran, inhabited by Caucasian ethnic groups; and the North Caucasus, which is located in the south of Russia and is also populated by Caucasian ethnic groups (Ismailov, E., and Z. Kengerli. 'The Caucasus in the Globalizing World: A New Integration Model', *Central Asia and the Caucasus*, 2/20, pp. 135-144, 2003; Ismailov, E., and V. Papava. 'A New Concept for the Caucasus', *Southeast European and Black Sea Studies*, 8/3, pp. 283-298, 2008; Ismailov, E., and V. Papava. *The Central Caucasus: Problems of Geopolitical Economy*. New York: Nova Science Publishers, 2008). Nevertheless, in this chapter, in order not to deviate from the entire context of this book, I will adhere to the traditional division of the Caucasus into the Northern and the Southern parts only.

The key goal of this chapter is to inquire into the qualitative aspects of the economic development of Armenia, Azerbaijan and Georgia.

Before embarking upon an analysis of the economic problems of the three South Caucasian countries, we will first consider some general tendencies, challenges and dangers that may be observed in practically all of the post-Communist countries. Each of them is exposed to the same general threats, including those of the South Caucasus.

### **Difficulties of the Market Transformations: “Leaders” and “Outsiders”**

Almost two decades have passed since the beginning of this historic process of transitioning to the market economy. Generalizing upon the accumulated experience<sup>2</sup> renders it possible to draw a number of very important conclusions about the path already traversed in transforming a Communist economy into a market economy.

Notwithstanding the plethora of scholarly publications on the subject of the transition period, there are no generally accepted criteria for determining its completion. But the simplest formal (and indeed external) resolution of this question seemingly suggests itself: if the European Union recognises this or that country with a transition economy as one that is ready to enter its ranks, then in all probability one should concede that the transition period in this country has been completed and that its functioning economic system for all practical purposes has become European and market-based.

As is well known, the acceptance of the majority of countries in Eastern Europe and the Baltics (Estonia, Latvia, and Lithuania) into the EU has in essence already been decided. On the whole, one can interpret this to mean the completion of the transition period; that is, the period of transition to the European type of market economy. In other words, these countries are “leaders” in passing through the transition period with success. Henceforth, the discussion herein will use the term “leaders” to designate these countries. What about the South Caucasian countries of Armenia,

---

<sup>2</sup> For example, Åslund, A. *How Capitalism Was Built: The Transformation of Central and Eastern Europe, Russia, and Central Asia*. New York: Cambridge University Press, 2007.

## QUALITATIVE ECONOMIC FEATURES

Azerbaijan, and Georgia or other post-Soviet countries like Moldova, Russia, and Ukraine – those who are “outsiders?” Are they still in the transitional period?

It is obvious that these countries, which were “outsiders,” are still far from developing European-style capitalism.

Capitalism by its nature is not homogenous.<sup>3</sup> The transitional period in “outsider” post-Communist countries has ended but, unfortunately, the economic (and not only economic) system of some of them is far from a European style of capitalism. It is better to qualify such a system as “Post-Communist Capitalism,”<sup>4</sup> that is, a society, which cannot be squeezed into the classic understanding of the word “capitalism” or within any other theoretically generalised model of capitalism.<sup>5</sup> The logic of this problem appears to be rather simple: if the collapse of the Communist system was essentially simultaneous in the countries of Eastern Europe and the former USSR, it follows that initially all were basically in the same situation and, consequently, the dragging out of the transition period to European capitalism is an artificial delay in making reforms in the economy (and in society, more broadly). This all-inclusive answer in itself contains many questions about the causes of the artificial slowdown in the process of reform which has resulted in Post-Communist Capitalism.

As the key to understanding the principal problems of post-Communist transformation in the “outsider” countries, it is expedient to conduct a comparative analysis of these countries with the “leaders” described above.

From the very incipience of the transition period, one special circumstance of great importance was not taken into account: the presence of the institutions of statehood. In particular, the states that were formed as a result of the collapse of the federal formations (above all, the Soviet Union

---

<sup>3</sup> For example, Dahms, H.F., ed. *Transformations of Capitalism: Economy, Society and the State in Modern Times*. Hampshire, UK: MACMILLAN PRESS, 2000; Gwynne, R.N., T. Klak and D.J.B. Shaw. *Alternative Capitalisms. Geographies of Emerging Regions*. London, UK: ARNOLD, 2003.

<sup>4</sup> Papava, V. *Necroeconomics: The Political Economy of Post-Communist Capitalism*. New York: iUniverse, 2005.

<sup>5</sup> For example, Coates, D. *Models of Capitalism: Growth and Stagnation in the Modern Era*. Cambridge, UK: Polity Press, 2000.

and the Socialist Federal Republic of Yugoslavia) and that were not the direct legal successors of these federal states lacked the institutions of statehood. As a result, their process of transition was compounded by the need to construct these institutions from the very beginning.<sup>6</sup> Under these conditions, the implementation of economic reforms according to schemas that had counted upon the utilisation of the corresponding institutions of the state (which were lacking in these countries) was foreordained to failure.

The advantage of the majority of the “leader” countries, compared with the “outsider” countries, was the presence of institutions of statehood, which significantly simplified and, thereby, accelerated the resolution of tasks associated with the transition to a market. Nevertheless, this factor cannot be deemed decisive in delaying the transition to a market in all “outsider” countries, for there are the examples of Slovakia, Slovenia and the Baltic countries, as EU member states, or Croatia, as an EU membership candidate country, all of which had to build state structures from scratch upon independence. Their example refutes the thesis about the fundamental impossibility of a rapid transition to a market amidst the process of creating these state institutions. As for the success of these countries in the matter of reforming their economies and, simultaneously, constructing the institutions of statehood, this is above all explained by the targeted thrust of measures adopted by the reformist governments in these countries. This, in turn, is explained by the human factor.

The human factor, as a rule, has decisive significance in practically any economic process. The character and possible success of economic reform in countries with a transition economy depend, to a large degree, upon the behavior of the person who finds himself in a transition process from *Homo Sovieticus* (i.e., someone who was formed under the conditions of a command economy and hence someone who was suppressed by the state and totally dependent upon it) to the type of person characteristic of a market economy, *Homo Economicus* (i.e., someone whose driving motivation is to receive the maximum utility in his household and the maximum profit in his firm). The type of person who carries out the process of post-Communist transformation is characterised herein by the

---

<sup>6</sup> Balcerowicz, L. *Socialism, Capitalism, Transformation*. Budapest: CEU, 1995, p. 146.

term, *Homo Transformativus* – someone who cannot completely emancipate himself from fear of the state and from the habit of living at the latter's expense; such is the case even though he is gradually beginning to act upon the basis of his own private interests in order to achieve maximum utility and profit.<sup>7</sup> Because of the fact that the Communist regimes in “leader” countries ruled almost half as long as in the “outsider” countries, the type of person called *Homo Sovieticus* did not have time to develop fully. At the same time, *Homo Economicus* was not totally eradicated as happened in the “outsider” countries at the end of the 1930s. Consequently, in the “outsider” countries *Homo Transformativus* was dominated by the characteristic features of *Homo Sovieticus*; by contrast, in the “leader” countries, the features of *Homo Economicus* prevailed. It is precisely this difference, which explains the greater readiness of *Homo Transformativus* in the “leader” countries to undertake the transition to a market, in contrast to the situation in the “outsider” countries.

### **Heritage of the Command Economy and the Threats from the Global Financial Crisis**

The absence of competition in command economies quashed the only effective stimulus for economic development. After the collapse of the Communist regimes and their command economies, the countries of the former Soviet Union found themselves with only a very small amount of goods to supply to the global market. With few exceptions, such as some hydro energy outputs, oil and gas extraction, and the primary processing of raw materials, the goods they manufactured failed to meet the high international standards as a result of their overall low quality and or high prices. In fact, no markets existed for these particular products. Moreover, in principle, there was no way that they could have existed; an economy of this type is nothing more than a corpse or a so-called “necroeconomy.”<sup>8</sup>

---

<sup>7</sup> Papava, V. “The Georgian Economy: From ‘Shock Therapy’ to ‘Social Promotion,’” *Communist Economies & Economic Transformation*, 8/8, pp. 251-267, 1996.

<sup>8</sup> Papava, V. “Necroeconomics—the Theory of Post-Communist Transformation of an Economy,” *International Journal of Social Economics*, 29/9/10, pp. 796-805, 2002; Papava, V. *Necroeconomics: The Political Economy of Post-Communist Capitalism*.

Specifically, in the post-Communist countries, a necroeconomy has grown on top of the roots of the command economy's technical bases. The carrier of the necroeconomy's routine<sup>9</sup> is a *Homo Transformativus*.

The majority of the necroeconomy in the public sector, as a rule, consists of large- and medium-sized processing industry enterprises that depend upon the types of goods they produce. When privatised, they move to the privatized necroeconomy.

The privatized necroeconomy indicates that a change in ownership by itself does not automatically entail the restarting of formerly idle enterprises. In other words, a “corpse’s” status does not depend upon whether it is owned by the government or a private firm.

The contemporary global financial crisis has created complex problems for the world, including the economic development of the South Caucasian countries. It is precisely within the context of the current crisis that the subject of the attack of zombie-firms upon the global economy has become so topical.<sup>10</sup> The insolvent and, in fact, bankrupt firms that continue to operate despite their “mortality” are commonly referred to as “zombie-firms.”<sup>11</sup>

A system of continued lending is the key source of the sustainability of these zombie-firms<sup>12</sup> with their loans granted by so-called “zombie-banks,” which extend beneficial credits to the firms (in particular, interest rates for such loans are lower than average rates at the market level).<sup>13</sup>

---

<sup>9</sup> Nelson, R., and S. G. Winter. *An Evolutionary Theory of Economic Change*. Cambridge: The Belknap Press of Harvard University Press, 1982.

<sup>10</sup> For example, Krugman, P. ‘The Big Dither’, *The New York Times*, March 05, 2009. Available from: <<http://www.nytimes.com/2009/03/06/opinion/06krugman.html>>; Krugman, P. “Wall Street Voodoo,” *The New York Times*, January 18, 2009. Available from: <[http://www.nytimes.com/2009/01/19/opinion/19krugman.html?\\_r=2&partner=rssnyt&emc=rss](http://www.nytimes.com/2009/01/19/opinion/19krugman.html?_r=2&partner=rssnyt&emc=rss)>.

<sup>11</sup> For example, Hoshi, T. “Economics of the Living Dead,” *The Japanese Economic Review*, 57/1, pp. 30-49, 2006.

<sup>12</sup> Caballero, R.J., T. Hoshi, and A.K. Kashyap. “Zombie Lending and Depressed Restructuring in Japan,” *American Economic Review*, 98/5, pp. 1943–1977, 2008; Smith, D.C. “Loans to Japanese Borrowers,” *Japanese International Economics*, 17/3, pp. 283–304, 2003.

<sup>13</sup> Smith, D.C., *ibid*.

## QUALITATIVE ECONOMIC FEATURES

It is an established fact that many developed and post-Communist countries have resorted to certain special governmental bailout programmes in support of their financial institutions and real estate businesses, thus threatening to develop a zombie-economy. This threat may become quite real if the financial crisis continues long enough to enable the zombie-firms to take solid root.

It is precisely the financial crisis, which creates the favorable conditions for the establishment of zombie-economy foundations – that is, the zombie-ing of an economy. The zombie-ing of a necroeconomy is what happens in the post-Communist countries<sup>14</sup> which, in fact, is even worse than the simple economic zombie-ing that takes place in developed economies.

Consequently, the most important challenge for the South Caucasian countries and their economic development is to avoid their economy's zombie-ing.

It is important to note that in Russia, for example, the first symptoms of necroeconomic zombie-ing emerged in the immediate aftermath of the August 1998 crisis in the country, which gave rise to the phenomenon of the post-Communist zombie-economy.<sup>15</sup>

Theoretically, it must be made clear that the effective elimination of a necroeconomy and zombie-economy is unthinkable without an effective bankruptcy law. As the experience of many post-Communist countries has shown, most of the past attempts at formally adopting bankruptcy laws have unfortunately produced only “stillborn babies.”<sup>16</sup>

---

<sup>14</sup> Papava, V. “Problema zombirovania postkommunisticheskoi’ nekroekonomiki’ (Zombification of the Post-Communist Necroeconomy),” *Vestnik instituta Kennana d Rossii* (Kennan Institute Bulletin in Russia), 15, pp. 37-48, 2009; Papava, V. “Post-Communist Capitalism and the Modern World of Dead Economy,” *Bulletin of the Georgian National Academy of Sciences*, 3/2, pp. 198-203, 2009.

<sup>15</sup> Lindsey, B. *Against the Dead Hand: The Uncertain Struggle for Global Capitalism*. New York: John Wiley & Sons, 2002, pp. 210-211.

<sup>16</sup> Sánchez-Andrés, A., and J.M. March-Poquet. “The Construction of Market Institutions in Russia: A View from the Institutionalism of Polanyi,” *Journal of Economic Issues*, XXXVI/3, pp. 1-16, 2002.

### **On the Economy of the Soviet South Caucasus and the First Steps of its Transition to the Market**

The South Caucasus is distinguished by its extremely diverse landscape and natural-geographical conditions. This, as well as the interests of territorial distribution of production in the former USSR, helped to form the special features of economic development in the South Caucasian countries.<sup>17</sup>

The economy of Soviet Armenia was characterized by the chemical industry, the production of ferrous metals, machine-tools, precision tools, textiles, clothing, leather footwear, and so on. Particular mention should be made of electric power generation and of the atomic power station, which was and still is the only one in the entire South Caucasus. Cognac production in the food industry still occupies a special place in the Armenian economy.

The economy of Soviet Azerbaijan was characterized by a sufficiently developed industrial base. This primarily applies to oil production and oil refinery, while metallurgy and the production of mineral fertilizers, fuels, lubricants, herbicides and synthetic rubber were also of great importance. Cotton-, wool- and footwear-manufacturing plants should be singled out among the enterprises of the light industry. As for agriculture, its produce was consumed not only in Azerbaijan, but also in other regions of the former USSR.

A sufficiently developed industrial base was also characteristic of the economy of Soviet Georgia – metallurgy, the production of ferrous alloys, machine-building (agricultural machinery industry, aeronautical engineering, shipbuilding) and the machine-tool industry, and the chemical industry. Agricultural produce and foodstuffs (primarily wine, mineral water, tea and citrus fruit) were mainly exported beyond Georgia and were in demand essentially throughout the former USSR.

---

<sup>17</sup> Adamescu, A. A., and E. D. Silaev, eds. *Zakavkazskiy ekonomicheskiy raion. Ekonomiko-geograficheskiy ocherk* (The Transcaucasian Economic Region. Economic and Geographical Essay). Moscow: Nauka Publishers, 1973; Gachechiladze, R. G., M. A. Nadzhafaliyev, and A. D. Rondeli. "The Regional Development Problems of Transcaucasia," *Geoforum*, 15/1, pp. 65-73, 1984; Herzig, E. *The New Caucasus. Armenia, Azerbaijan and Georgia*. London, UK: Royal Institute of International Affairs, 1999.

## QUALITATIVE ECONOMIC FEATURES

The collapse of the Communist system, Soviet society and the disintegration of the USSR led to a breakdown in cooperative relations among the enterprises of the former Soviet Union and the disappearance of the system for supporting the consumption of these enterprises' products. The question of reorienting foreign trade became urgent. Most industrial enterprises of the South Caucasian countries (as of the whole of the former USSR) were incapable of meeting the demands of international competition, as they formed the network of the necroeconomy. The economy of each of these countries could not avoid the trend toward de-industrialization.

The Caucasus as a whole, and the South Caucasus in particular, was always and is still today a conglomerate of contradictions.<sup>18</sup> In recent years, this was manifested in the political processes and the ethnic conflicts going on in the region.<sup>19</sup> In addition, the Russian-Georgian war in August 2008<sup>20</sup> has made the situation in the region more complicated.

As a result of these political, economic, and other factors, essentially all the South Caucasian states have found themselves, to one extent or another, in a profound crisis encompassing all spheres of their vital activity and is leading to an abrupt slump in production, a high level of inflation and a decline in the standard of living.<sup>21</sup> The conflicts have had an especially negative effect on the economy of the South Caucasian countries, as a result of which they have lost their potential for economic development.<sup>22</sup>

---

<sup>18</sup> For example, Nuriyev, E. *The South Caucasus at the Crossroads: Conflicts, Caspian Oil and Great Power Politics*. Berlin: LIT, 2007.

<sup>19</sup> For example, Cornell, S. E. *Small Nations and Great Powers: A Study of Ethnopolitical Conflict in the Caucasus*. Surrey: Curzon Press, 2001; Herzig, E., *ibid*, pp. 44-83.

<sup>20</sup> For example, Cornell, S. E., and S. F. Starr, eds. *The Guns of August 2008: Russia's War in Georgia*. Armonk: M.E. Sharpe, 2009.

<sup>21</sup> Curtis, G.E., ed. *Armenia, Azerbaijan, and Georgia: Country Studies*. Washington, D.C.: Federal Research Division Library of Congress, 1995, pp. 41-57, 115-129, 190-206.

<sup>22</sup> Polyakov, E. *Changing Trade Patterns after Conflict Resolution in South Caucasus*.

Washington, D.C.: The World Bank, 2000. Available from:

<[http://lnweb18.worldbank.org/eca/eca.nsf/d1e66886eb626e2852567d100165168/23ac8865ee0dc520852568fc005ba956/\\$FILE/ATT00ZE9/Trade+flows3.pdf](http://lnweb18.worldbank.org/eca/eca.nsf/d1e66886eb626e2852567d100165168/23ac8865ee0dc520852568fc005ba956/$FILE/ATT00ZE9/Trade+flows3.pdf)>.

## SOUTH CAUCASUS 2021

In 1996, Azerbaijan's GDP amounted to 42 percent of the 1990 level;<sup>23</sup> the volume of production and industrial output significantly decreased – in 1995, it was 72 percent of the 1990 level.<sup>24</sup> Before 1994, the economy of Armenia was in a depressed state; in particular, economic potential decreased by almost 90 percent, the GDP dropped ten-fold and the volume of industrial production shrank by 80 percent.<sup>25</sup> In Georgia, the GDP for 1990-1994 dropped by 72 percent, and the volume of industrial production fell by 84 percent.<sup>26</sup>

Beginning in 1994-1995, thanks to actively carrying out a reform policy, trends toward stabilization and improvement of the economy were observed in the South Caucasian states,<sup>27</sup> but the consequences of the global financial crisis were so profound that it will take more than one year to overcome them. What is more, success will be contingent on a radical and constructive domestic economic policy, as well as on an optimal combination of the interests of all the states of this region and the active attraction of foreign investments.<sup>28</sup>

Taking into account that the economic reforms in the South Caucasian countries are being carried out with the direct participation of the International Monetary Fund (IMF) and the World Bank (WB), it is not surprising that these reforms themselves are by nature essentially of the

---

<sup>23</sup> Samedzade, Z. *Etapy bol'shogo puti. Ekonomika Azerbaidzhana za polveka, ee osnovnye realii i perspektivy* (Stages in a Long Journey. The Economy of Azerbaijan over Fifty Years, Its Main Realities and Prospects). Baku: Nurlar Publishers, 2004, p. 463.

<sup>24</sup> Gajiev, K. S. *Geopolitika Kavkaza* (Geopolitics of the Caucasus), Moscow: Mezhdunarodnye otnoshenia Publishers, 2003, p. 104.

<sup>25</sup> Gajiev, K. S., *ibid.*, p. 125.

<sup>26</sup> Papava, V. G., and T. A. Beridze. *Ocherki politicheskoi ekonomii postkommunisticheskogo kapitalizma (opyt Gruzii)* (Essays on the Political Economy of Post-Communist Capitalism (the Georgian Experience)). Moscow: Delo i servis Publishers, 2005, p. 162.

<sup>27</sup> Herzig, E., *ibid.*, pp. 119-146; Khachatryan, V. "Basic Trends in Armenia's Economic Development in 1991-2001," *Central Asia and the Caucasus*, 2/14, pp. 130-135, 2002; Papava, V. "The Georgian Economy: Problems of Reform," *Eurasian Studies*, 2/2, pp. 52-62, 1995; Rasulov, F. "The Social-Economic Situation and the Prospects for the Economic Development of Azerbaijan," in B. Rumer, and Lau S. Y., eds., *Central Asia and South Caucasus Affairs*: 2003. Tokyo: The Sasakawa Peace Foundation, 2003, pp. 325-338.

<sup>28</sup> For example, Nuriyev, E., *ibid.*; Starr, S.F. "The Investment Climate in Central Asia and the Caucasus," in J. H. Kalicki, and E. K. Lawson, eds., *Russian-Eurasian Renaissance? US Trade and Investment in Russia and Eurasia*. Washington, D.C.: Woodrow Wilson Center Press, 2003, pp. 73-91.

same type. Here it should be noted that Azerbaijan, with significant hydrocarbon supplies, did not hurry to actively cooperate with the international financial institutions. As a result, it was a little later with its market reforms than Armenia and Georgia.

### **The Global Financial Crisis and the Anti-Crisis Measures of the South Caucasian Governments**

Although financial markets are not well-developed in the countries of the South Caucasus it was expected that even these countries could not escape any negative implications of the global financial crisis. According to the IMF, whilst the economic growth rate across the countries of the South Caucasus and the Central Asia amounted to 12 percent a year in 2007, up from six percent in 2006, this indicator was expected to drop to less than two percent in 2009.<sup>29</sup> In fact the real GDP growth rate was 3.9 percent in 2009, and compared to other nations of the region, this economic decline was particularly drastic in Armenia and Georgia.<sup>30</sup> Unsurprisingly, the IMF has closely cooperated with countries of the South Caucasus.<sup>31</sup>

The impact of the global economic crisis upon the countries of the South Caucasus is not homogeneous at all. There is much in common between Armenia and Georgia, both of which are open economies<sup>32</sup> with no significant deposits of hydrocarbon resources. The key differences between

---

<sup>29</sup> For example, Jardaneh, D. "Crisis Brings Reversal of Fortune to Caucasus and Central Asia," *IMF Survey Magazine: Countries & Regions*, March 10, 2009. Available from: <<http://www.imf.org/external/pubs/ft/survey/so/2009/car030909c.htm>>.

<sup>30</sup> Regional Economic Outlook: Middle East and Central Asia. Washington, D.C.: International Monetary Fund, 2010, p. 53. Available from: <<http://www.imf.org/external/pubs/ft/reo/2010/mcd/eng/10/mreo1024.pdf>>.

<sup>31</sup> Burke, M. "IMF Lends Armenia \$540 Million to Counter Crisis Impact," *IMF Survey Magazine: Countries & Regions*, March, 10, 2009. Available from: <<http://www.imf.org/external/pubs/ft/survey/so/2009/CAR030909B.htm>>; "Azerbaijan—Aide Mémoire for the 2008 IMF Staff Visit Discussions, December 10-17, 2008, Baku," *IMF External Relations Department*, December 16, 2008. Available from: <<http://www.imf.org/external/np/ms/2008/121608b.htm>>; "Current IMF-Supported Program," *Program Note: Georgia*, August 17, 2009. Available from: <<http://www.imf.org/external/np/country/notes/pdf/georgia.pdf>>.

<sup>32</sup> Georgia and Armenia have been members of the World Trade Organisation (WTO) since June 14, 2000 and February 5, 2003, respectively. Azerbaijan has been negotiating its WTO membership.

the two are associated with the Russian-Georgian War of August 2008, which had some specific consequences for Georgia's economy.<sup>33</sup> As for Azerbaijan, its revenues from oil and gas exports make for a rather different economic picture of this Caucasian country. Further, some similar approaches have been observed in the anti-crisis measures of the governments of all of the three countries of the Central Caucasus.<sup>34</sup>

In the absence of any serious deposits of natural resources, the global financial crisis had a very serious impact upon Armenia. This country was also gravely affected by the Russian-Georgian War. In particular, according to official sources, the direct and indirect damage caused to Armenia by the war is estimated to amount at USD 700 million.<sup>35</sup> For the first eight months of 2009, the GDP accounted for just 81.6 percent of its amount for the same period of 2008.<sup>36</sup> In fact, the real GDP in 2009 accounted for only 85.9 percent of Armenia's real GDP from 2008.<sup>37</sup>

As was expected, the crisis primarily hit the country's industrial sector wherein the enterprises of necroeconomy are concentrated. In 2008, the production rate in metallurgical and chemical industries fell to 9.6 and 14.8 percent, respectively, as compared to 2007.<sup>38</sup> In this regard, it must be noted that only 98.7 percent of the total industrial production volume was sold in 2008 and, more remarkably, some 70 percent of those sales took place in the

---

<sup>33</sup> Papava, V. "Post-War Georgia's Economic Challenges," *Central Asia-Caucasus Analyst*, 10/23, November 26, 2008. Available from: <<http://www.cacianalyst.org/?q=node/4991>>; Papava, V. "Georgia's Economy: Post-revolutionary Development and Post-War Difficulties," *Central Asian Survey*, 28/2, pp. 199-213, 2009.

<sup>34</sup> For example, "Government Offers New Plan to Boost Economy," *Civil.Ge, Daily News Online*, June 30, 2009. Available from: <<http://www.civil.ge/eng/article.php?id=21180>>; Khachatryan, H. "Armenia: How a Small Country Counters the Global Crisis," *Caucasus Analytical Digest: The Caucasus in the Global Financial Crisis*, No. 6, May 21, pp. 5-7, 2009. Available from: <<http://www.res.ethz.ch/analysis/cad/details.cfm?lng=en&id=100521>>, p. 6; Masimli, A. "Azerbaijan and the World Financial Crisis," *The Caucasus & Globalization*, 3/1, pp. 68-83, 2009, pp. 81-83.

<sup>35</sup> Khachatryan, H. "Republic of Armenia: Economy," in *Central Eurasia 2008*. Luleå: CA&CC Press, pp. 48-54, 2009, p. 48.

<sup>36</sup> "Main Statistical Data," *National Statistical Service of the Republic of Armenia*, 2009. Available from: <<http://www.armstat.am/en/>>.

<sup>37</sup> "Time series," *National Statistical Service of the Republic of Armenia*. Available from: <<http://www.armstat.am/en/?nid=126&id=01001>>.

<sup>38</sup> Khachatryan, H. "Republic of Armenia: Economy," p. 51.

## QUALITATIVE ECONOMIC FEATURES

domestic market,<sup>39</sup> which is a clear indication of the necroeconomic nature of some key sectors of the Armenian economy. So, the main problems in the Armenian economy are concentrated in the real sector.<sup>40</sup>

In November 2008, the Armenian Government came up with an anti-crisis programme that, inter alia, provides for the support of local industries by means of subsidising or issuing governmental guarantees to companies experiencing certain difficulties and even taking a stake in some of them.<sup>41</sup> Under the framework of this approach, more than 20 companies have already received governmental assistance in the aggregate amount of USD 67 million.<sup>42</sup> Obviously, the Armenian economy is exposed to a critical danger of zombie-ing under the conditions of the global financial crisis.

Presently, there is broad consensus over the fact that Azerbaijan has suffered the least damage from the global financial crisis as compared to the other countries of the post-Soviet world.<sup>43</sup>

An effective factor, which weakens the impact of the global crisis upon Azerbaijan's economy, is the country's foreign currency reserves that have been accumulated by means of oil and gas exports and that have created a so-called "safety cushion" for the country's economy.<sup>44</sup>

As was to be expected, particular hardships have been suffered by necroeconomic enterprises – specifically, the steel, aluminium and chemical industries.<sup>45</sup> Pursuant to official statistics, while the growth of the gross volume of industrial products in Azerbaijan reached 103.9 percent during the first eight months of 2009 as compared to the same period in 2008, the

---

<sup>39</sup> Ibid.

<sup>40</sup> Aris, B. "Armenian Banks Suffer at Hands of Real Economy," *bne – businessneweurope*, September, pp. 49-50, 2009, p. 50.

<sup>41</sup> Khachatryan, H. "Armenia: How a Small Country Counters the Global Crisis," p. 6.

<sup>42</sup> Ibid, p.7.

<sup>43</sup> For example, Hübner, G., and M. Jainzik. "Splendid Isolation? Azerbaijan's Economy Between Crisis Resistance and Debased Performance," *Caucasus Analytical Digest: The Caucasus in the Global Financial Crisis*, No. 6, May 21, pp. 12-15, 2009. Available from: <<http://www.res.ethz.ch/analysis/cad/details.cfm?lng=en&id=100521>>, p. 12.

<sup>44</sup> Hasanov, R. "Azerbaijan Republic: Economy," in *Central Eurasia 2008*. Luleå: CA&CC Press, pp. 83-91, 2009, p. 91.

<sup>45</sup> Hübner, G., and M. Jainzik, *ibid*, p. 13.

non-oil sector has demonstrated some decline; that is, the production rate for the same period of 2009 comprised only 94.3 percent of the similar indicator for the same period in 2008.<sup>46</sup> The City of Sumgayit, which is Azerbaijan's third largest city by population and was famous in the Soviet period for its military-industrial complex, presently represents a classic example of a necroeconomic center. Almost all of its enterprises – namely the state-owned chemical company Azerkimya plants, the state-owned Azerboru pipe factory and Azeraluminum – remain either completely idle or work at extremely low capacities.<sup>47</sup>

Also inoperative (or close to that status) are all steel and metal-rolling factories, which were created in the years of Azerbaijan's independence – namely, the Baku Steel Company, Baki Poladtekme JSC and DHT Metal JSC.<sup>48</sup>

One has to bear in mind the fact that the system of Azerbaijan's economic management still retains some old-fashioned institutional schemes. These include the independent disposition by almost all state-owned large industrial and infrastructure companies of their material and financial resources, the availability for many of those companies of some large budget assignments and their privilege of enjoying some “tax holidays.”<sup>49</sup>

In early 2009, the Government of Azerbaijan came up with a package of anti-crisis measures. It includes some preventive steps against the artificial growth of prices on the consumer market as well as those aimed at strengthening the anti-monopoly regulation of the economy; the prevention of the government's illegal interference in the economy; the

---

<sup>46</sup> “Macroeconomic Indicators,” *The State Statistical Committee of the Republic of Azerbaijan*, September 14, 2009. Available from: <<http://www.azstat.org/macroeconomy/indexen.php?estat=archive&topic=30>>. The fact is that after August of 2009, the data of the non-oil sector's growth volume of industrial products, unfortunately, was not published.

<sup>47</sup> Abbasov, S. “Beyond Energy Exports, the Global Downturn is Battering Local Industry,” *Eurasia Insight*, April 27, 2009. Available from: <<http://www.eurasianet.org/departments/insightb/articles/eav042709.shtml>>.

<sup>48</sup> Abbasov, S. “Azerbaijan: Global Crisis Hits Baku Banks and Real Estate Sector,” *Eurasia Insight*, December 01, 2008. Available from: <<http://www.eurasianet.org/departments/insightb/articles/eav120108a.shtml>>.

<sup>49</sup> Hasanov, R. “Management in Transition Economies: An Azerbaijan Republic Case Study,” *The Caucasus & Globalization*, 3/1, pp. 84-91, 2009, pp. 89-91.

## QUALITATIVE ECONOMIC FEATURES

depositing of foreign currency reserves, which are kept abroad in the most reliable of local banks, and ensuring reliable governmental control over the investing of these resources in the real sector of economy; improving the government's investing policy; strengthening its control over the spending of budgetary funds; enhancing assistance to export-oriented enterprises; increasing the volume of privileged loans to businessmen; and intensifying the government's support of agriculture.<sup>50</sup>

The existence of the large necroeconomic sector, as well as the practice of financing businesses from public resources as one of the methods of combating the crisis, is a clear indication of exposure of the economy of Azerbaijan (including the necroeconomy) to the danger of zombie-ing, which was discussed above in the general context of post-Communist countries.

After the five-day Russian-Georgian War in August 2008,<sup>51</sup> and due to the global financial crisis, Georgia has come to face some new economic challenges.<sup>52</sup> The negative effects of the Georgian economic crisis might have been far more distressing had the international community not extended a helping hand in response to Russia's military aggression. At the conference held in Brussels under the aegis of the World Bank in October 2008, it was decided to allocate USD 4.55 billion in financial aid for post-war Georgia, of which USD 2 billion is a grant and the remainder a loan.<sup>53</sup> Georgia will receive these funds during 2008-2010 and a major part of it will be spent for the liquidation of economic damage caused to Georgia by the Russian military aggression.

2009 has hitherto been marked with an apparent decline in the Georgian economy. In the first half of the year, Georgia's GDP rate accounted for

---

<sup>50</sup> Masimli, A., *ibid*, p. 81.

<sup>51</sup> Cornell, S. E., and S. F. Starr, eds., *ibid*.

<sup>52</sup> Corso, M. "Georgia's Expansion Halts," *Caucasus Analytical Digest: The Caucasus in the Global Financial Crisis*, No. 6, May 21, pp. 5-7, 2009. Available from: <<http://www.res.ethz.ch/analysis/cad/details.cfm?lng=en&id=100521>>; Papava, V. "Post-War Georgia's Economic Challenges."

<sup>53</sup> *Georgia: Summary of Joint Needs Assessment. Prepared for the Donors' Conference of October 22, 2008 in Brussels*. The United Nations, The World Bank, 2008. Available from: <[http://www.mof.ge/common/get\\_doc.aspx?doc\\_id=5994](http://www.mof.ge/common/get_doc.aspx?doc_id=5994)>.

## SOUTH CAUCASUS 2021

only 89.3 percent of its own level in 2008, and finally the real GDP in 2009 accounted only 96.2 percent of that from 2008.<sup>54</sup>

The main problem in Georgia's economy is that, with the government's lesser control of the developments in the construction sector, the industry became dominated by "financial pyramids."

Under such circumstances, the ten largest companies of Georgia significantly reduced their production capacities and some stopped operating entirely<sup>55</sup> creating thereby favourable conditions for the succession of a necroeconomy.<sup>56</sup> Although the government periodically buys large amounts of fertilizer from Georgia's largest chemical factory, Azot, even this enterprise has had to stop its production.<sup>57</sup> Most surprisingly, however, these enterprises continued producing their products for the first months of 2009, in the "best" tradition of a necroeconomy and despite the obvious crisis in the Georgian economy, even though there was no demand for their output. They simply stopped their activities in April and May when the warehouses were completely filled with unwanted products.<sup>58</sup>

To help the country overcome the economic crisis, the Government of Georgia developed a so-called "new financial package," basically targeted to strengthen the banking and construction sectors.<sup>59</sup> Specifically, the government is planning to issue some treasury bills, which will be invested in infrastructure projects. The government, thereby, aims to provide some assistance to commercial banks that are going to be the key recipients of those treasury bills. In times of economic crisis, the treasury bills will enable the banks to raise some assured incomes from the national budget funds. In addition, the package provides for the weakening of the governmental regulation of banks. As a result, the government hopes that the banks will

---

<sup>54</sup> "Gross Domestic Product," *National Statistics Service of Georgia*. Available from: <[http://www.geostat.ge/index.php?action=page&p\\_id=119&lang=eng](http://www.geostat.ge/index.php?action=page&p_id=119&lang=eng)>.

<sup>55</sup> Aris, B. "Donor Money Keeps Georgia Afloat," *bne – businessneweurope*, August, pp. 59-61, 2009, p. 61.

<sup>56</sup> Papava, V., and M. Tokmazishvili. "Necroeconomic Foundations and the Development of Business in Post-Revolution Georgia," *Caucasus and Globalization*, 1/4, pp. 84-95, 2007.

<sup>57</sup> Aris, B. "Donor Money Keeps Georgia Afloat," p. 61.

<sup>58</sup> *Ibid.*

<sup>59</sup> "Government Offers New Plan to Boost Economy."

be able to attract some additional lending resources. Further, the package envisages the issuance by the Tbilisi City Hall of some financial guarantees to construction companies as a means of encouraging banks to lend money to the construction companies, which will then be spent for the renovation of the old sections of the capital.

As one can see, although the problem of necroeconomy in times of an economic crisis is still a very timely one, fortunately, the government's anti-crisis plans have hitherto not given any indication that the government is going to finance necroeconomic facilities. On the other hand, it must be remembered that no official bankruptcy proceedings have been initiated to this point with respect to any of the necroeconomic enterprises of Georgia. Furthermore, as was noted above, the Government of Georgia is going to provide financial assistance to the construction companies, many of which represent "financial pyramids." This is nothing else but a step toward the zombie-ing of those construction companies and also of those banks, which will be extending loans to such construction companies owing to the financial guarantees from Tbilisi's City Hall.

Under the conditions of the global financial crisis, the South Caucasian countries need to combine their efforts in developing and adopting effective bankruptcy legislation in order to avoid the threat of economic zombie-ing.

### **On the Economic Rapprochement with the EU**

The key challenge for the South Caucasian countries is to achieve some level of general European economic standards and in this way to promote their economic development.<sup>60</sup> Thus, in the South Caucasian countries, the promotion their economic development must be a result of the rightly planned and implemented market-oriented reforms.

For the South Caucasian countries, transition to the free trade regime with the EU may become both a strong incentive and an effective mechanism to

---

<sup>60</sup> For example, Sekarev, A. "European Integration Process of Georgia, the Republic of Armenia and the Republic of Azerbaijan: Achievements, Shortcomings, Challenges," in *Moving Closer to Europe? Economic and Social Policies in Georgia, Armenia and Azerbaijan*. Tbilisi: Centre for Economic Problems Research. Available from: <http://cepr.ge/images/doc/CEPR%20FES%20Book%20ENG.pdf>.

address their major challenge of achieving a general level of European economic standards. It will force these nations to carry out rather effective measures to implement consistent economic reforms. At the same time, the transition to the free trade regime will encourage and attract some new foreign investments which, in the long run, will result in the relative acceleration of economic growth rates.

Since 2004, all of the three South Caucasian countries have cooperated closely with the EU within the framework of the European Neighborhood Policy (ENP). In 2007, they joined the EU's Black Sea Synergy (BSS) initiative. In 2009, they also became involved in a brand new EU initiative called the Eastern Partnership (EaP).<sup>61</sup>

Despite Armenia's deep-rooted and somewhat controversial strategic partnership with Russia,<sup>62</sup> the European orientation is a clear foreign policy priority for Yerevan.<sup>63</sup> Furthermore, the Government of Armenia considers a free trade regime with the EU to be one of the key objectives of its foreign policy.<sup>64</sup>

Azerbaijan is interested in expanding its economic and trade cooperation with the EU even though EU membership will not be the country's priority in the foreseeable future. This may be explained, first of all, by a greater level of economic independence as compared to its South Caucasian neighbours, enjoyed by Azerbaijan due to its significant revenues raised from oil and gas.<sup>65</sup> Azerbaijan will need to join the WTO in order to obtain a free trade regime with the EU. The achievement of this goal will be contingent upon Azerbaijan's ability to carry out some significant reforms aimed at a greater liberalisation of its economy. It is important to note that

---

<sup>61</sup> For example, Mkrtchyan, T., T. Huseynov, and K. Gogolashvili. *The European Union and the South Caucasus. Three Perspectives on the Future of the European Project from the Caucasus. Europe in Dialogue 2009/01*. Gütersloh: Bertelsmann Stiftung, 2009.

<sup>62</sup> For example, Minassian, G. "Armenia, a Russian Outpost in the Caucasus?" *Russie.Nei.Visions*, No. 27, February 15, 2008. Available from: <[http://www.ifri.org/files/Russie/ifri\\_RNV\\_minassian\\_Armenie\\_Russie\\_ANG\\_fevr2008.pdf](http://www.ifri.org/files/Russie/ifri_RNV_minassian_Armenie_Russie_ANG_fevr2008.pdf)>.

<sup>63</sup> Mkrtchyan, T., T. Huseynov, and K. Gogolashvili, *ibid*, p. 14.

<sup>64</sup> Khachatryan, H. "New Partnership with European Union Prompts Hopes in Armenia," *Eurasia Insight, Eurasianet*, November 30, 2006. Available from: <<http://www.eurasianet.org/departments/insight/articles/eav113006a.shtml>>.

<sup>65</sup> Mkrtchyan, T., T. Huseynov, and K. Gogolashvili, *ibid*, pp. 7, 83.

## QUALITATIVE ECONOMIC FEATURES

the EU has expressed its readiness to be Azerbaijan's partner in Baku's efforts to reach this goal. It is believed that Armenia and Azerbaijan are primarily interested in the EU as a counterweight to Russia.<sup>66</sup>

After the Russian-Georgian war of August 2008, the EU's role with respect to Georgia has significantly expanded.<sup>67</sup> The transition to the free trade regime was decided by the Extraordinary European Council, which met in Brussels on September 1, 2008.<sup>68</sup> The free trade regime is dependent upon Georgia's meeting those conditions, which Brussels has requested to be observed within the format of the ENP. These include the adoption of a new labor code, which would secure the same employee protections as found in the EU itself, and the enactment of European-style anti-monopoly and consumer rights protection legislation.

Although the Georgian government has generally welcomed the EU's initiative regarding the free trade regime, the EU's free trade regime preconditions to Georgia regrettably have hitherto been disregarded by Tbilisi. Neither the Letter of Intent sent by the Georgian Government to the IMF on September 9, 2008, for example, nor the Memorandum of Economic and Financial Policies for 2008-2009<sup>69</sup> make any impression that in the observable future the Georgian Government plans to amend the Labor Code and to adopt new European-standard anti-monopoly and consumer rights protection legislation. To put it in other words, the Georgian Government is by no means hurrying to implement a transition to the free trade regime with the EU.<sup>70</sup>

---

<sup>66</sup> For example, Lobjakas, A. "EU Goes Back to Drawing Board in South Caucasus," *Radio Free Europe/Radio Liberty*, September 10, 2009. Available from: <[http://www.rferl.org/content/EU\\_Goes\\_Back\\_To\\_Drawing\\_Board\\_In\\_South\\_Caucasus/1819518.html](http://www.rferl.org/content/EU_Goes_Back_To_Drawing_Board_In_South_Caucasus/1819518.html)>.

<sup>67</sup> Mkrtchyan, T., T. Huseynov, and K. Gogolashvili, *ibid*, pp. 104-105.

<sup>68</sup> *Extraordinary European Council, Brussels, 1 September, 2008, 12594/08*. Presidency Conclusions. Brussels: Council of the European Union, 2008. Available from: <[http://www.consilium.europa.eu/ueDocs/cms\\_Data/docs/pressData/en/ec/102545.pdf](http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/102545.pdf)>.

<sup>69</sup> *Georgia: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, September 9*. Washington: The International Monetary Fund, 2008. Available from: <<http://www.imf.org/External/NP/LOI/2008/geo/090908.pdf>>, p. 10.

<sup>70</sup> Papava, V. "Is Georgians' European Dream Any Part of Government Policy?" *The Georgian Times*, December 15, 2008. Available from: <<http://www.geotimes.ge/index.php?m=home&newsid=14166>>.

## Conclusions

The transitional period in “outsider” post-Communist countries has ended but, unfortunately, the economic (and not only economic) system of some of them is far from a European style of capitalism. The phenomenon of the “outsider” post-Communist countries can be explained by the human factor.

The dead enterprises, which the “outsider” countries received as their legacy of the command economy, have proven to be quite “tenacious of life.” As a consequence, the market economies of “outsider” countries have been loaded by the burden of a necroeconomy.

The occurrence of financial crises has encouraged the emergence of a kind of routine that guarantees the stability of a government’s bailout programs implemented through the banking sector in support of de-facto bankrupt firms. As a result, a network of zombie-banks and zombie-firms develops, upon which the entire system of a zombie-economy rests.

This threat of an economy’s zombie-ing is even greater in the “outsider” countries given that this zombie-ing also has a great deal to do with a necroeconomy, which is a factor that will make it rather difficult to improve an economy’s health after the end of the financial crisis.

The only effective mechanism to get rid of both a necroeconomy and a zombie-economy is to adopt a sound bankruptcy law which, in turn, requires the strong political will of the ruling elite.

In the absence of any serious deposits of natural resources, the global financial crisis had a very serious impact upon Armenia. As was to be expected, the crisis primarily hit the country’s industrial sector and, particularly, metallurgical and chemical industries wherein the enterprises of a necroeconomy are concentrated. The Armenian Government came up with an anti-crisis programme that, inter alia, provides for the support of local industries by means of subsidising or issuing governmental guarantees to companies experiencing certain difficulties and even taking a stake in some of them. Obviously, the Armenian economy is exposed to a critical danger of zombie-ing under the conditions of the global financial crisis.

## QUALITATIVE ECONOMIC FEATURES

Azerbaijan's ability to cope with the global financial crisis – greater than that of any other post-Soviet country – is fueled by the following two factors: the underdevelopment of the financial sector and the domination of the oil and gas sector within the national economy. As was to be expected, particular hardships have been suffered by necroeconomic enterprises such as, specifically, the steel, aluminium and chemical industries. The existence of a necroeconomic sector, as well as the practice of financing businesses from public resources as one of the methods of combating the crisis, is a clear indication of the exposure of the economy of Azerbaijan (including the necroeconomy) to the danger of zombie-ing.

The summary economic indicators for 2008 clearly reflect the implications of both the global financial crisis and the Russian military aggression against Georgia. In Georgia, the economic crisis also has its own domestic roots. Under such circumstances, the ten largest companies in Georgia have significantly reduced their production capacities, with some of them having stopped operating entirely and, therefore, creating favorable conditions for the succession of a necroeconomy. Although the problem of a necroeconomy in times of an economic crisis is still very timely, fortunately, the government's anti-crisis plans have hitherto not given any indication that the government is going to finance necroeconomic facilities. On the other hand, no official bankruptcy proceedings have been initiated to this point with respect to any of the necroeconomic enterprises of Georgia. Furthermore, the Government of Georgia is going to provide financial assistance to construction companies, many of which represent "financial pyramids." This is nothing else but a step towards the zombie-ing of those construction companies and also of those banks, which will be extending loans to such construction companies.

For the South Caucasian countries, transition to a free trade regime with the EU may become both a strong incentive and an effective mechanism to address their major challenge, which consists of achieving a general level of European economic standards. Doing so will be vital to Armenia's, Azerbaijan's and Georgia's ability to further promote their economic development.